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EXCEPTION

BEFORE THE ARIZONA CORPORATION COMMISSION

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2008 MAR -6 A 10: 29

AZ CORP COMMISSION
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IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY,
AN ARIZONA CORPORATION, FOR A
DETERMINATION OF THE CURRENT FAIR
VALUE OF ITS UTILITY PLANT AND
PROPERTY AND FOR INCREASES IN ITS
RATES AND CHARGES BASED THEREON
FOR UTILITY SERVICE BY ITS SUN CITY
WASTEWATER AND SUN CITY WEST
WASTEWATER DISTRICTS.

Docket No. WS-01303A-06-0491

Arizona Corporation Commission

DOCKETED

MAR 6 2008

DOCKETED BY

**EXCEPTIONS OF
THE RESIDENTIAL UTILITY CONSUMER OFFICE**

The Residential Utility Consumer Office ("RUCO") makes the following Exceptions to the Recommended Opinion and Order ("ROO") on Arizona American Water Company's ("Arizona American" or "Company") application for a rate increase.

**NORTHWEST REGIONAL WASTEWATER TREATMENT FACILITY ("NWVTF")
ALLOCATION.**

The ROO recommends that a portion of the NWVTF (32%) be included in the rate base of the Company's Anthem/Aqua Fria wastewater district. ROO at 5. This is an unusual recommendation based on an unprecedented ratemaking approach, which will have the end

1 result of increasing rates in the already overtaxed ratebase of Anthem/Aqua Fria district which
2 soon is likely to have some of the highest rates in the state even without the proposed
3 allocation. In addition to the 32% ratebase allocation, the ROO recommends that a similar
4 allocation be made for the operation and maintenance expenses associated with the NWVTF
5 used to treat the Anthem/Aqua Fria wastewater. Id. While RUCO agrees that the residents of
6 Anthem/Aqua Fria should pay their fair share for the service provided, trading and transferring
7 portions of each district's ratebase to accommodate the situation is not the proper ratemaking
8 treatment. The better solution is to treat the costs associated with the Anthem/Aqua Fria's use
9 of the NWVTF as an operating lease.

10 The ROO claims it would be more efficient to treat the flows from the Sun City West Sun
11 City Wastewater District and the Anthem/Aqua Fria District together rather than to build
12 separate facilities in each district. RUCO does not take issue with the ROO's conclusion;
13 however, the conclusion misses RUCO's point. RUCO is not suggesting that the Company
14 build two plants or that it is more or less efficient to treat the Anthem/Aqua Fria wastewater
15 elsewhere. The issue simply concerns the best ratemaking treatment for the situation.

16 The ROO's recommendation relies on Staff's Engineer's conclusion regarding the
17 relative percentage of the NWVTF that has been built and not in use (33%). See Exh. S-1,
18 Exhibit DMH-3 at 3-4, ROO at 4. Staff's final recommendation to allocate 32% of the NWVTF
19 to the Anthem/Aqua Fria District was made on the second to last day of the hearing, without
20 the benefit of pre-filed testimony or prior notification to RUCO¹.

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24 ¹ Prior to Staff's 32% allocation recommendation, Staff and the Company were recommending an allocation
of 2.25%.

1 If, as Staff testifies, 33% of the NWVTF's capacity is not in use, then the issue is one of
2 excess capacity for ratemaking purposes. The proper ratemaking treatment of excess
3 capacity is not to allocate it to another District's ratebase. RUCO is not aware of the
4 Commission ever treating excess capacity in this manner for ratemaking purposes and the
5 Commission should not start a new precedent in this case.

6 RUCO has no basis to disagree with Staff's conclusion that 32% of the NWVTF's
7 capacity is not in use. On the other hand, RUCO has not had the opportunity to audit Sun City
8 West's growth and analyze other factors to determine the appropriateness of the 32%
9 allocation. What, for example would happen if the Commission were to approve the proposal
10 and Sun City West should need 80 percent of the NWVTF capacity to treat its wastewater in
11 the next couple of years? If the Commission approves the ROO, the ratebase allocation will
12 have already been made and will be wrong if the NWVTF continues to treat Sun City West's
13 actual capacity requirements. It would be bad ratemaking to approve a 32% allocation under
14 the circumstances of this case². (See Exhibit A, RUCO's Amendment No. 1)

16 **ACCUMULATED DEPRECIATION**

17 The ROO rejects RUCO's adjustment to increase Accumulated Depreciation by
18 \$962,479. A portion of that adjustment, \$445,393 concerns what the Company admits were
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22 ² The ROO refers to Staff and the Company's recommendation to allocate 32% as being made later in the
23 case. That is an understatement. Staff proposed its "new proposal" on August 28, 2007 – the second to last
24 day of hearing. Staff obviously knew about it beforehand but failed to advise RUCO. RUCO did not cross-
examine or do any discovery as Staff has suggested because quite frankly, RUCO had not had an
opportunity to think about and analyze the new recommendation before the transcripts were issued and the
final Briefs were due. RUCO's point here is not to be critical of the process, but to explain why it believes
further analysis is necessary.

1 improper recordings of retirements in its reconciliation sheets. R-1, Attachment-1. These
2 recordings were in fact plant transfers, and not retirements and according to the Company's
3 prior Senior Regulatory Analyst, Joel Reiker, "there should be no retirement effect on
4 accumulated depreciation." Id. The ROO, however, recommends that there should be a
5 retirement effect on accumulated depreciation in the amount of \$445,393 and that RUCO's
6 adjustment should be rejected. ROO at 8.

7 The ROO relies on the testimony of the Company's current rate analyst, Cheryl
8 Hubbard. Ms. Hubbard explains that she did not make an adjustment to put the
9 mischaracterized retirements back in the accumulated depreciation account because they did
10 not come out of the accumulated depreciation account on the Company's books. ROO at 8.
11 The Company claims that there is a difference between the accumulated depreciation account
12 that it keeps on its books for accounting purposes and the accumulated depreciation account it
13 keeps on its plant reconciliations for ratemaking purposes. Transcript at 315. The Company
14 further admits that there is an unreconciled balance of the accumulated depreciation account
15 on its rate case reconciliation workpapers. Id. At the end of the day, however, it is the rate
16 case reconciliation sheets that the Company has submitted in support of its application and is
17 used for ratemaking purposes. The fact that the Company is unable to reconcile the books it
18 uses for accounting purposes with the books it uses for ratemaking purposes should not count
19 against the ratepayers. The Company's reconciliation sheets speak for themselves and are
20 the best proof of how the Company has treated the retirements for ratemaking purposes. The
21 effects of the improperly recorded retirements are still in the accumulated depreciation account
22 for ratemaking purposes and should be removed. R-1, Attachment 1. (See Exhibit B, RUCO's
23 Amendment No. 2)

1 **RATE CASE EXPENSE**

2 The ROO recommends that the Company be awarded its proposed rate case expense
3 of \$253,962 amortized over three years. ROO at 13. The ROO's recommendation is
4 excessive in this case. Specifically, the ROO recommends the Company recover \$143,000 in
5 cost for its rate design witness. The Company requested the same amount in its recent
6 Mohave case. The Commission rejected its request, noting:

7 We believe the Company's proposed expense of
8 \$143,000 for a consultant to analyze rate design and cost of
9 service issues is excessive, especially when, as RUCO points
10 out, Arizona-American was able to contract for comparable
11 services in the recent Paradise Valley case at a cost of only
12 \$25,000."

13 Decision No. 69440 at 12.

14 RUCO is not suggesting that the Company not recover its expenses for the additional
15 work required by the rate design issue. The Company's request to recover \$143,000 for its
16 rate design witness is \$118,000 more than what the Commission determined appropriate in
17 Paradise Valley. The difference in the amount of work involved, however, is disproportionate
18 to the increase the ROO recommends in this case. The amount of additional work was not
19 extraordinary. The Company prepared a volumetric rate design – it did not do an in-depth
20 analysis which would have included cost-benefit studies and consumer surveys. The
21 Company's rate design witness, Charles Loy, explained that the scope of his work included the
22 review of the Company's general accounting records, monthly financial information and
23 discussions with management personnel and other knowledgeable witnesses. A-5 at 9. Mr.
24 Loy also examined supporting documentation to develop proof of revenues, normalized
revenues and cost of service by class. Id at 9-10. RUCO's recommendation which provides
for an additional \$11,600 is reasonable and should be approved by the Commission.

1 The ROO also agrees with the Company's request to recover \$30,000 for its cost of
2 capital witness. ROO at 15. According to the ROO, \$30,000 is a reasonable request. Id.
3 RUCO does not question the amount the Company seeks. RUCO is seeking a 50/50 sharing
4 of the cost between ratepayers and shareholders. R-1 at 24. RUCO's adjustment is based on
5 the belief that there should be an equal sharing of this cost between the ratepayers and
6 shareholders. Id. The shareholders receive the benefit of higher returns, thus greater profits,
7 through the efforts of the Company's cost of capital witness. Therefore, the costs associated
8 with her services should also be shared equally. Id.

9 The Commission reached the same conclusion in the Company's recent Mohave case.
10 In Decision No. 69440 the Commission noted:

11 We also find that that [sic] the recommendation to reduce the cost of
12 capital consultant's expenses from \$90,000 to \$45,000 to be
reasonable in this case.

13 Decision No. 69440 at 12.

14 The ROO provides no explanation as to why it diverges from the Commission's prior
15 precedent on this issue. The Commission should be consistent and lower the rate case
16 expense recommended in the ROO. (See Exhibit C, RUCO's Amendment No. 3)

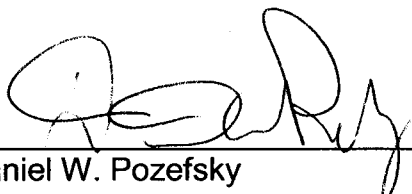
17 18 **RATE DESIGN**

19 For the most part, RUCO is satisfied with the ROO's recommendation regarding
20 residential rate design. RUCO, however, feels compelled to remind the Commission that the
21 ROO's recommendation for commercial volumetric rates will have a significant impact on many
22 of the commercial classes which, indirectly, will affect residential ratepayers. Because of the
23 different proposed revenue requirements for Staff and the Company, RUCO is unable to
24 discern the exact impact the ROO will have on commercial users. However, both Staff and the

1 Company submitted "typical bill analysis" which when considered together indicate that the
2 ROO's impact will be significant for many commercial classes. For example, under Staff's
3 proposal, the proposed rate fluctuations in Sun City range from a decrease of (68.52%) for
4 Commercial Large 5/8 to 3/4 inch Single Unit users to an estimated monthly increase of
5 25,042.33% for Commercial 6 inch Multi Unit users. S-36.

6 Under the Company's volumetric proposal, the proposed rate fluctuations in Sun City
7 range from a decrease of 14.42% for Commercial Large 1 1/2 inch multi-users to an estimated
8 monthly increase of 7,254.33% for Commercial 4 inch single-users. A-6, CEL R-4. In Sun City
9 West the proposed rate fluctuations range from a decrease of (40.23%) for Commercial 6 inch
10 multi-users users to an estimated monthly increase of 1,689.09% for Commercial 3 inch single-
11 users. A-6, CEL R-6. RUCO is not proposing an amendment to rate design.

12
13 RESPECTFULLY SUBMITTED this 6th day of March 2008.

14
15
16 
17 Daniel W. Pozefsky
Attorney

18 AN ORIGINAL AND THIRTEEN COPIES
19 of the foregoing filed this 6th day
20 of March 2008 with:

21 Docket Control
22 Arizona Corporation Commission
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Phoenix, Arizona 85007

1 COPIES of the foregoing hand delivered/
2 mailed this 6th day of March 2008 to:

3 Teena Wolfe
4 Administrative Law Judge
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9 Christopher Kempley, Chief Counsel
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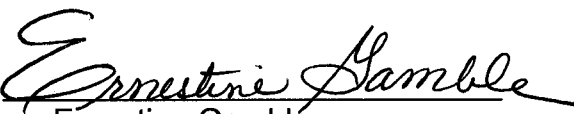
22 By 
23 Ernestine Gamble
24 Secretary to Daniel W. Pozefsky

Exhibit A
RUCO's Amendment No. 1

Page 5 Lines 4-15

DELETE The Paragraph.

INSERT We agree with RUCO that it is appropriate for ratemaking purposes to treat the percentage of Anthem/Aqua Fria District's wastewater treated at the North West Valley Treatment Facility during the test year (2.25%) as an operating lease. It is not appropriate for ratemaking purposes for the Company which owns several districts to trade and transfer portions of each districts ratebase among each other. Therefore, the Company and Staff's request to allocate 32% of Sun City West Wastewater's ratebase to the Anthem/Agua Fria District and the associated operating expenses will also be rejected.

Make all conforming changes.

Exhibit B
RUCO'S Amendment No. 2

Page 8 line 9

INSERT After parenthetical - These recordings were in fact plant transfers, and not retirements and according to the Company's prior Senior Regulatory Analyst, Joel Reiker, "there should be no retirement effect on accumulated depreciation." See Surrebuttal Testimony of RUCO Witness Timothy J. Coley, Ex. R_1, Attachment 1.

Page 8 line 16

INSERT After parenthetical - The Company's witness further testified at hearing that there is a difference between the accumulated depreciation account that the Company keeps on its books for accounting purposes and the accumulated depreciation account it keeps on its plant reconciliations for ratemaking purposes. Transcript at 315. The witness also admitted that there is an unreconciled balance of the accumulated depreciation account on its rate case reconciliation workpapers. Transcript at 315.

Page 9 line 17 through line 20

DELETE The last two sentences of the paragraph.

INSERT The Company's explanation fails to replace the \$445,393 of what the Company admits were improper reductions to the Company's accumulated depreciation account. The effects of the improperly recorded retirements are still in the accumulated depreciation account for ratemaking purposes and should be removed. We adopt RUCO's proposed adjustment, in part, to replace \$445,393 to the Company's accumulated depreciation account.

Make all conforming changes.

Exhibit C
RUCO'S Amendment No. 3

Page 15 lines 15 – 22.

DELETE The Paragraph.

INSERT We agree with RUCO that the Company's proposed rate case expense appears to be excessive considering the facts of this case. We believe the Company's proposed expense of \$143,000 for a consultant to analyze rate design and cost of service issues is excessive, especially when Arizona-American was able to contract for comparable services in its recent Paradise Valley rate case at a cost of only \$25,000. We do, however, agree that additional work was required for the rate design issue in this case, and agree with RUCO that an additional \$11,600 is reasonable. We also find that the recommendation to share the Company's expenses associated with its cost of capital consultant between shareholders and ratepayers is also reasonable. Accordingly, based on the totality of the evidence presented on this issue, we will reduce total rate case expense from \$253,962 to \$150,562, divided equally between the districts, and amortized over three years.

Make all conforming changes.